VZCZCXRO5923
PP RUEHBZ RUEHDU RUEHGI RUEHJO RUEHMA RUEHMR RUEHPA RUEHRN RUEHTRO
DE RUEHDK #0105/01 0271326
ZNR UUUUU ZZH
P 271326Z JAN 09
FM AMEMBASSY DAKAR
TO RUEHC/SECSTATE WASHDC PRIORITY 1770
INFO RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUEHLMC/MCC WASHDC
RUEHZO/AFRICAN UNION COLLECTIVE

UNCLAS SECTION 01 OF 03 DAKAR 000105

SIPDIS

DEPT FOR AF/W, AF/EPS, F/PCRAWFORD, EEB/IFD/OMA AND EBB/EPPD

E.O. 12958: N/A
TAGS: EAID EFIN ECON SOCI KMCA SG
SUBJECT: FOREIGN ASSISTANCE IMPACT OF GLOBAL FINANCIAL CRISIS ON SENEGAL

REF: A) Dakar 0062, B) 08 State 134905

DAKAR 00000105 001.2 OF 003

¶1. Summary: In response to Ref B request, Post submits the following information on the possible impact of the global financial crisis on assistance programs in Senegal. Ref A and previous reports have outlined the general impact of the global financial crisis on Senegal's broader economic conditions. Much of our concern about the possible impact on USG assistance is derived from new limitations on the host government's ability to fulfill its obligations as an effective partner for our development and military assistance. The GOS's difficulties with budget management exacerbate the problem. At the same time, many of our programs, including significant new funds for agriculture development are designed to help the country cope with global economic downturns. In this regard, a new approach from Washington permitting greater flexibility in the programming of assistance money would be beneficial. End summary.

THE ECONOMIC REALITIES IMPACTING ASSISTANCE PROGRAMS

¶2. Senegal's difficult current economic conditions will likely make the implementation of donor assistance somewhat more difficult. These conditions are the result of the combination of influences which are broadly exacerbated by the global financial crisis, and include:
-- the government's large internal debt;
-- current and projected GDP growth below five percent;
-- very tight commercial bank liquidity;
-- a limited market for new treasury bond issuances;
-- a significant drop in foreign remittances;
-- Senegal's lack of value-added exports; and
-- the government's funding decisions which may be influenced more by political than economic considerations.

¶3. Economic slowdown, especially in Europe, the U.S., and China will directly impact Senegal's economic fundamentals. Senegal's national budget and its population are highly vulnerable to price fluctuations in food and petroleum products. At the same time, the country's domestic economy rests on a thin foundation, with peanuts, phosphates, cotton, seafood, and tourism accounting for the large majority of export earnings. As discussed in Ref B, remittances are another very important source of foreign currency, household income, and anti-poverty relief. Some estimates calculate that these transfers account for more than 10 percent of GDP, but the country is already noticing a marked drop-off in remittances as the employment market slows in the U.S. and Europe.

¶4. Senegal's high dependence on foreign assistance is another key variable for Senegal's economic performance, middle-class income, and over-all development capacity. Under the GOS' 2009 budget framework, the Ministry of Finance is anticipating that aid will account for 29.3 percent of the country's total budget, an increase from the 2008 target of 26.1 percent. Any tightening of official

development assistance not only in Western capitals, but also from China and Middle East countries, will have a direct correlation on Senegal's bottom line.

POSSIBLE IMPACT ON USG BILATERAL ASSISTANCE

¶5. The impact of the global financial crisis on Senegal in and of itself will likely have little direct impact on USG bilateral assistance. The GOS's ability to function as an effective partner due to its own budget and capacity constraints could prove challenging in the near term. While Senegal's current budget difficulties are mostly caused by its large internal debt, any additional shock from the global financial crisis will exacerbate the problem. This could decrease public expenditures in sectors the USG is supporting and hinder some of our foreign assistance programs and priorities. For example, under an innovative arrangement, USAID is financing the construction of middle schools throughout the country, but requires that the GOS reimburse the account for the cost of the construction. Even in spite of a significant current budget deficit, the government has been able to hold up its end of this arrangement, but with any additional squeeze on resources, future financing of these schools could become increasingly difficult.

¶6. Another hallmark of USAID's programs in Senegal is the promotion of sustainable exploitation of natural resources by local rural communities under the "Wula Nafaa" project. This effort, however, depends on rural poor to be financially stable enough to take a long-term view towards their natural resources. We are concerned that the effective and accountable stewardship of resources promoted by the project will be threatened when families are faced with increasing hunger and diminished incomes. If the response is a return to unregulated charcoal production and the unsustainable harvest of tropical timber, Senegal's already diminished forest resources could fall to critical levels.

DAKAR 00000105 002.2 OF 003

COMMUNITY/GRASS-ROOTS PROGRAMS

¶7. With Senegal's budget facing renewed pressure, the government's commitment to decentralization could flag. Because local elections are scheduled for March, it is likely that there will be a flow of politically-motivated project funds to regions and constituencies outside of Dakar. However, beyond that, we suspect that the national ministries and agencies will use their political influence to protect their budgets and that the flow of money to local governments could diminish. Under this scenario, the need for grass-roots assistance will increase so that enhanced U.S. foreign assistance money for the Ambassador's Self-Help Fund, the Democracy and Human Rights Fund, and the Peace Corps, could pay additional dividends.

SLOWING AGRICULTURE DEVELOPMENT?

¶8. The financial crisis's impact on our growing agricultural development and commercial capacity-building programs is uncertain. New programs currently under development by USAID seek to solve some of the very problems that can be anticipated from the global financial crisis. For instance, USAID Senegal has just received an additional USD23 million of FY09 funds from the Global Food Security Response to higher food prices. A continued, consistent response at this level will greatly assist Senegal to weather some of the potential negative impacts of the financial crisis - particularly food security.

¶9. At the same time, our agriculture and natural resources management goals are focused on improving local production, processing, and trade capacities that ultimately require private sector investment. Should further analysis indicate that new private investment will not keep pace with the development program, USDA and USAID programs in the agricultural sector (which are just beginning to ramp up) may need to be modified somewhat. Under this scenario, USG money may be required to target less capital-intensive sectors, or perhaps to use funds to make targeted capital investments where they are lacking.

¶10. The current USAID portfolio already has programs in place that will help address potential impacts of the financial crisis. However, the large amount of earmarks on the USAID budget removes flexibility for USAID to take into account unseen effects of the financial crisis that are not already being addressed.

¶11. As the regional Foreign Agricultural Service Officer points out, our broader policy positions could also be impacted. For example, in the cotton sector, the U.S. is supporting privatization and reform across West Africa (Senegal is in fairly good shape, relatively speaking) and these efforts are challenged by huge local debts that will likely grow in the midst of the current financial crisis. The slowdown in world economic growth has diminished world cotton demand, which has exacerbated an already delicate financial situation by lowering cotton revenues and increasing private and state-held debt in this and other key employment sectors.

¶12. Governments across the region as well as international donors (including the World Bank) have consistently bailed out the cotton sector since, politically, a sector that employs tens of millions across the region cannot be allowed to fail. Senegal's "cotton" may be "peanuts," where a lack of capital in the agro-processing sector threatens the income of thousands of peanut farmers, and millions of dependent family members. The current financial crisis changes the calculation on this dynamic. The price tag for propping up these sectors has grown significantly, while their structural deficiencies make future bailouts a very poor investment. Should Senegal (and other countries) face a new rural economy crisis and an accompanying deterioration in social stability, the employment/poverty aspect of the equation could well go beyond the financial and political cost to governments and donors. U.S. policy interests related to reform, fiscal responsibility, free trade, and free and open economies could also prove more difficult to achieve

¶13. In addition, Senegal is on track for a Millennium Challenge Corporation Compact designed to build rural infrastructure that will positively impact the country's agriculture sector. This model of investing in infrastructure is a good example of how bilateral assistance could actually have a greater relative impact for investments in irrigation and roads given the current difficulties for the government in raising funds through treasury bonds or via local financing.

U.S. MILITARY ASSISTANCE

¶14. We also note the possibility for a negative impact on our military training and cooperation as the global financial crisis may compound the difficulties which Senegal faces in sustaining its

troop contributions to UN Missions. Senegal recently committed itself to increasing its troop commitment from 2,218 to 2,413. While existing programs such as the Africa Contingency Operations and Training Assistance, Sudan Supplemental Funds, and UN equipment stipends cover most all of Senegal's operational support expenses, Senegal will likely continue to struggle to maintain its U.S.-origin equipment used in these UN operations because we expect that the GOS discretionary budget will be very tight and concessional financing to address the government's internal debt will remain difficult for the country to secure. Maintenance of U.S.-origin weapons and trucks is particularly expensive for Senegal since there are no distributors for those spare parts in West Africa. If Senegal's defense budget is reduced, as will likely be the case, the Armed Forces will struggle to maintain those items which are already suffering significant wear and tear from UN operations, particularly in Darfur.

POSSIBLE IMPACT ON OTHER DONOR ACTIVITIES

¶15. Our contacts at other Embassies and development agencies are uniformly concerned about the possibility that ODA budgets will decrease in 2009. As with our programs, there is widespread concern that the GOS will not be able to partner as fully on assistance as previewed when programs were developed. We anticipate that direct budget support by a number of donors will be subject to review in

capitals, not only due to belt-tightening, but also because Senegal has struggled to keep on track its IMF Policy Support Instrument and prove that it is taking much-needed reforms in fiscal management and accountability.

¶16. In addition to ODA assistance, Senegal benefits from an alphabet soup of NGOs providing development and anti-poverty assistance. Many of these are implementing partners for donors, and even more are operating their own programs via charitable contributions. We anticipate that a significant number of these organizations will cut back on projects and staff as a direct consequence of the global economic downturn.

COMMENT

¶17. It is difficult to predict with any certainty the eventual impact on Senegal of the global financial crisis, but many of our programs already exist to help build safety nets for the rural poor by improving education, natural resource management, and improved agricultural systems to increase food security. As Washington agencies develop plans for adjusting our foreign assistance to meet new challenges presented by the global economic downturn, we hope that a couple of key considerations are brought to the table. First, as noted above, Post's ability to adjust our programs to meet new and perhaps unanticipated problems in anti-poverty goals and government budgets are often hindered by the lack of flexibility in many USG foreign assistance programs. The majority of USAID and FAS funds are earmarked by Congress or Washington agencies to be programmed under a fairly narrow band of activities. These agencies effectively design and implement programs in response to specific constraints and are appropriately targeted. However, greater Post-implemented flexibility on funds would be beneficial. Second, Washington policymakers should continue to push governments in developing countries to improve their fiscal performance by enhancing transparency and accountability and focusing national budgets on key priorities. This is not only a question of good policy, but also of maintaining responsible partnerships by making the most of their internal resources.

BERNICAT